

## Case study 8

Chapter 22: Financial accounts

Chapter 23: Ratio analysis

### Mowmaster Ltd

Denzel Jackson is considering buying a company called Mowmaster Ltd that makes lawnmowers. He has been given the financial statements for the last two years and he needs to make a decision about whether to buy. He knows that the recession means that home owners are not buying as much garden equipment as before. Nevertheless, he feels that grass always grows and so there will always be a need for a mower to cut it.

Mowmaster Ltd. was established in 1998. The current owner, Rodney Bernard, says that he wants to sell in order to sail around the world. Denzel has heard that Mowmaster has been experiencing some liquidity and gearing problems over the last year. Rodney says this is only because he bought new machinery and that all that is needed is for short-term bank loans to be converted into long-term loans. Denzel is not sure about this, but he has noticed that there seems to be a good stock of impressive lawnmowers in the warehouse.

#### Profit and loss account for Mowmaster Ltd January to December 2009 and 2010

(\$000)

	2009	2010
Sales revenue	432	476
Cost of goods sold	144	216
Gross profit	288	260
Overheads	108	140
Net profit before interest and tax	180	120
Interest	36	52
Tax	29	14
Net profit after interest and tax	115	38
Dividends	100	36
Retained profit	15	2

**Balance sheet for Mowmaster Ltd at 31 December 2009 and 2010**

(\$000)

	<b>2009</b>	<b>2010</b>
<b>FIXED ASSETS</b>		
Buildings	950	920
Machinery	<u>80</u>	<u>290</u>
	1030	1210
<b>CURRENT ASSETS</b>		
Stocks	108	145
Debtors	196	292
Cash	<u>36</u>	<u>8</u>
	340	445
<b>CURRENT LIABILITIES</b>		
Trade creditors	150	290
Short-term loans	100	120
Overdraft	<u>45</u>	<u>25</u>
	295	435
<b>NET CURRENT ASSETS</b>	45	10
<b>NET ASSETS</b>	1075	1220
Financed by:		
<b>LONG-TERM LIABILITIES</b>		
Mortgage	300	290
Bank loan	135	288
<b>CAPITAL &amp; RESERVES</b>		
Share capital	400	400
Retained profits	240	242
<b>CAPITAL EMPLOYED</b>	1075	1075

**SL questions: 20 marks, 35 minutes**

- 1 Define the following terms:
  - a overdraft (2)
  - b debtors. (2)
- 2 Calculate Mowmaster's current ratio in 2009 and 2010. What could Denzel conclude from these figures? (7)
- 3 Use an appropriate efficiency ratio to analyse changes in creditors and stock. (7)
- 4 Mowmaster's gross profit ratio has dropped. State **two** reasons why this may have happened. (2)

**HL questions: 25 marks, 45 minutes**

- 1 Define the term 'liquidity'. (2)
- 2 Calculate **two** efficiency ratios for Mowmaster Ltd for 2009 and 2010. What could Denzel conclude from these calculations? (7)
- 3 Use calculation of gearing for 2010 to advise Denzel whether it would be possible to convert bank short-term debt to a term loan. (6)
- 4 Analyse changes in Mowmaster's profitability. (5)
- 5 Evaluate whether Denzel should buy Mowmaster Ltd. (5)